

FDIC State Profile

Spring 2006

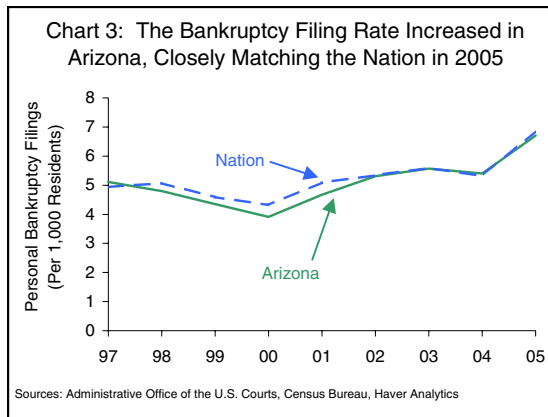
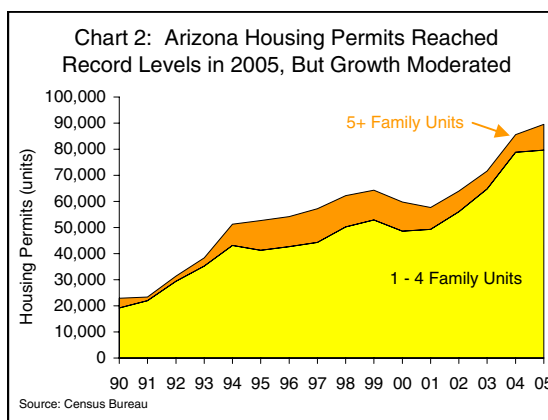
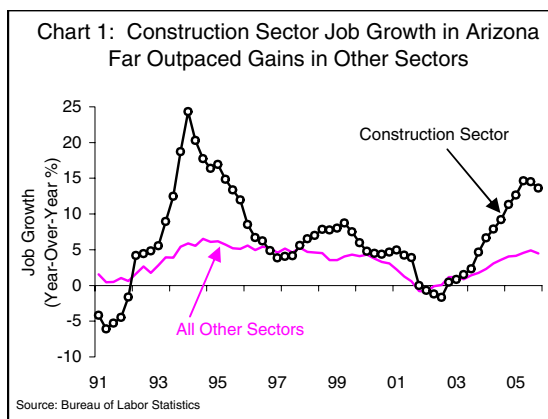
Arizona

Arizona continued to rely heavily on the cyclical construction sector for job growth.

- Arizona maintained its ranking as the second fastest growing state in the nation as employment gains accelerated to 5.3 percent in fourth quarter 2005.
- Strong population inflows and continued demand for new homes fueled job gains. The state's construction sector reported a 13.6 percent growth rate during fourth quarter 2005 and accounted for nearly one in five new jobs (see Chart 1). Gains in all other sectors, led by business services, retail trade, and leisure sectors, were comparatively flat.
- **Phoenix** added about 75 percent of the state's new jobs, but hiring was widespread as each of the state's metropolitan areas except **Tucson** added jobs at a pace more than triple the national rate of 1.4 percent in fourth quarter 2005.
- Forecasts indicate job gains in the state will ease somewhat in 2006 as construction activity cools.¹

Housing market conditions warrant monitoring.

- Although Arizona continued to attract new residents, housing permit issuance eased during 2005 (see Chart 2). Phoenix reported over 5,000 fewer single family permits in 2005 compared to 2004 levels, a decline of about 10 percent. This reversal could portend of a slowdown in construction activity.
- Deteriorating affordability, particularly in **Prescott**, **Tucson**, and Phoenix, and rising interest rates may further weigh on the housing market.
- Nevertheless, Arizona's year-over-year home price gains measured 34.9 percent in fourth quarter 2005, led by 39.7 percent gains in Phoenix, and outpaced all other states.
- Innovative mortgages and investors may be influencing Arizona housing demand.² Interest-only and negative



¹Forecast data from Moody's Economy.com.

²Based on subprime and Alt-A private mortgage securitizations tracked by LoanPerformance. Alt-A loans include mortgages that have near-prime credit quality, lack full loan documentation, or are secured by investor properties.

amortization loans accounted for 55 percent of non-prime mortgage originations during the first 11 months of 2005. During the same period, investors and second-home purchasers accounted for 30 percent of Arizona Alt-A mortgage originations.

Arizona consumers face increasing pressure.

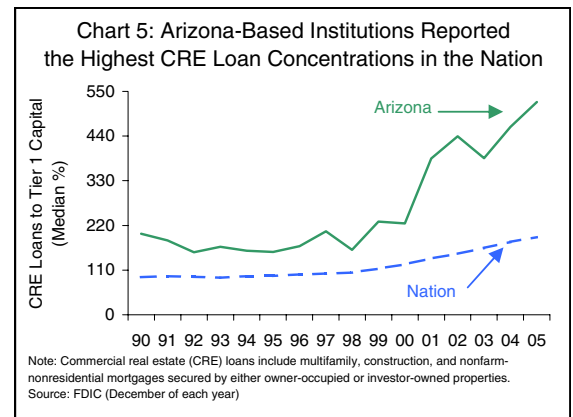
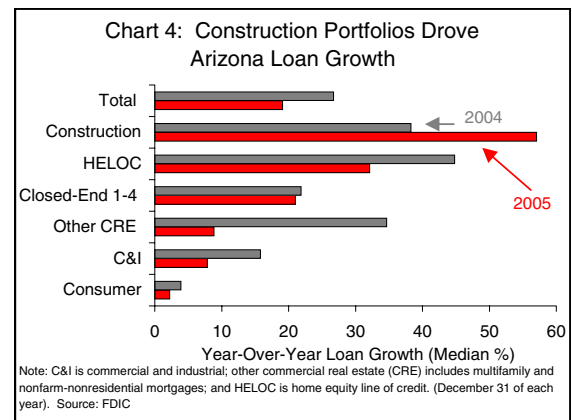
- Rising energy costs will continue to burden households' pocketbooks as the prices of both natural gas and electricity are forecast to increase further in 2006.³
- Personal bankruptcy filings in Arizona increased markedly in 2005, rising to 6.7 filings per thousand residents (see Chart 3). A large part of the increase reflected increased filings prior to the enactment of new bankruptcy legislation that took effect in October 2005. Forecasts indicate that the state's filing rate will decline in 2006, but then continue to trend upward in 2007.⁴

Although overall loan growth slowed, commercial real estate (CRE) concentrations remained high.

- Overall loan growth in Arizona moderated during 2005 to 19 percent but still ranked fourth nationally. Construction and development (C&D) portfolios grew at 57 percent, the third highest rate in the country and the fastest growing loan category among Arizona institutions (see Chart 4).
- As a result, nearly 70 percent of Arizona-based banks and thrifts held C&D loans in excess of Tier 1 capital by the end of 2005, compared to less than 26 percent of institutions at year-end 1997.
- Arizona ranked first in the nation at year-end 2005 for the highest median CRE loan to Tier 1 capital concentration of 524 percent versus a national median of 192 percent (see Chart 5).
- Home equity lines of credit (HELOC) and 1 – 4 family annual median loan growth reported by the state's institutions was the highest in the nation as of year-end 2005, even as the state's HELOC loan growth slowed to 32 percent, down from 45 percent at the prior year-end.
- Strong economic conditions continued to bolster Phoenix and Tucson CRE. Office and industrial markets in Phoenix reported the lowest vacancy rates since late 2000, and rents increased.
- As of fourth quarter 2005, Arizona-based institutions reported very low levels of past-due CRE loans, compared to a national median of 0.5 percent.

Rising interest rates boosted quarterly net interest margins (NIMs), but tempered investment portfolio values.

- Arizona insured institutions continued to report excellent quarterly earnings. The median fourth quarter pretax return on asset (ROA) ratio improved year-over-year to 1.5 percent ranking 14th nationally.
- NIMs were unchanged from the prior year as interest income rose sufficiently to offset increases in interest expense. Slight improvements in non-interest and provision expenses offset weaker fee income performance.
- Rising interest rates contributed to a decrease in the value of securities portfolios held by the state's institutions. In fourth quarter 2005, none of the state's banks recorded securities gains compared with 7 percent in the prior year.
- Overall past-due loan levels improved year-over-year to 0.12 percent, the second lowest delinquency rate in the nation.



³Forecast data from the Energy Information Administration's 2006 Annual Energy Outlook.

⁴Forecast filing rate calculated using Moody's Economy.com forecast data for bankruptcy filings and population.

Arizona at a Glance

ECONOMIC INDICATORS (Change from year ago, unless noted)

Employment Growth Rates	Q4-05	Q3-05	Q4-04	2004	2003
Total Nonfarm (share of trailing four quarter employment in parentheses)	5.3%	5.7%	4.6%	3.7%	1.4%
Manufacturing (7%)	1.8%	2.6%	2.9%	1.0%	-4.5%
Other (non-manufacturing) Goods-Producing (9%)	13.3%	13.8%	11.2%	8.6%	1.8%
Private Service-Producing (68%)	5.9%	6.0%	4.6%	4.0%	2.2%
Government (16%)	0.1%	1.5%	2.5%	1.5%	0.8%
Unemployment Rate (% of labor force)	4.7	4.8	4.6	5.0	5.7

Other Indicators	Q4-05	Q3-05	Q4-04	2004	2003
Personal Income	N/A	8.6%	9.9%	8.3%	5.3%
Single-Family Home Permits	1.2%	-6.7%	8.2%	20.9%	15.5%
Multifamily Building Permits	10.4%	47.9%	-21.8%	8.7%	-8.4%
Existing Home Sales	-7.7%	7.7%	23.0%	24.9%	16.7%
Home Price Index	34.9%	31.1%	16.3%	12.6%	5.8%
Nonbusiness Bankruptcy Filings per 1000 people (quarterly annualized level)	7.71	7.45	4.77	5.40	5.57

BANKING TRENDS

General Information	Q4-05	Q3-05	Q4-04	2004	2003
Institutions (#)	52	52	49	49	50
Total Assets (in millions)	81,251	77,125	59,321	59,321	60,773
New Institutions (# < 3 years)	11	12	10	10	13
Subchapter S Institutions	7	7	7	7	6

Asset Quality	Q4-05	Q3-05	Q4-04	2004	2003
Past-Due and Nonaccrual Loans / Total Loans (median %)	0.12	0.22	0.37	0.37	0.56
ALLL/Total Loans (median %)	1.04	1.14	1.06	1.06	1.17
ALLL/Noncurrent Loans (median multiple)	11.63	10.64	3.46	3.46	3.34
Net Loan Losses / Total Loans (median %)	0.00	0.00	0.00	0.00	0.03

Capital / Earnings	Q4-05	Q3-05	Q4-04	2004	2003
Tier 1 Leverage (median %)	9.85	9.70	10.27	10.27	9.90
Return on Assets (median %)	1.19	1.32	1.26	0.99	0.88
Pretax Return on Assets (median %)	1.53	1.79	1.32	1.13	1.16
Net Interest Margin (median %)	5.38	5.36	5.26	5.09	4.66
Yield on Earning Assets (median %)	7.34	7.12	6.56	6.26	5.98
Cost of Funding Earning Assets (median %)	2.23	2.09	1.44	1.28	1.30
Provisions to Avg. Assets (median %)	0.17	0.13	0.19	0.17	0.28
Noninterest Income to Avg. Assets (median %)	0.51	0.64	0.63	0.53	0.70
Overhead to Avg. Assets (median %)	3.75	3.69	3.87	3.68	3.74

Liquidity / Sensitivity	Q4-05	Q3-05	Q4-04	2004	2003
Loans to Assets (median %)	78.5	74.9	76.4	76.4	69.4
Noncore Funding to Assets (median %)	19.6	15.9	15.7	15.7	15.3
Long-term Assets to Assets (median %, call filers)	7.2	4.4	5.2	5.2	7.8
Brokered Deposits (number of institutions)	29	28	26	26	21
Brokered Deposits to Assets (median % for those above)	6.4	6.9	7.2	7.2	7.1

Loan Concentrations (median % of Tier 1 Capital)	Q4-05	Q3-05	Q4-04	2004	2003
Commercial and Industrial	90.7	80.4	114.0	114.0	110.9
Commercial Real Estate	523.6	511.2	462.3	462.3	385.9
Construction & Development	187.9	193.4	140.2	140.2	104.6
Multifamily Residential Real Estate	7.2	5.9	6.7	6.7	4.1
Nonresidential Real Estate	259.1	261.1	238.2	238.2	230.5
Residential Real Estate	81.4	78.4	89.1	89.1	76.4
Consumer	10.1	10.2	12.7	12.7	14.0
Agriculture	0.0	0.0	0.0	0.0	0.0

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits (\$ millions)	Asset Distribution	Institutions
Phoenix-Mesa-Scottsdale, AZ	65	52,219	< \$250 million	37 (71.2%)
Tucson, AZ	21	10,250	\$250 million to \$1 billion	9 (17.3%)
Prescott, AZ	12	2,857	\$1 billion to \$10 billion	5 (9.6%)
Yuma, AZ	9	1,223	> \$10 billion	1 (1.9%)
Flagstaff, AZ	8	882		